No. 20,771

IN THE

United States Court of Appeals

For the Ninth Circuit

SAYRE & COMPANY, LTD.,
Appellant,

vs.

R. A. RIDDELL, Commissioner of Revenue and Taxation,
Appellee.

On Appeal from the Judgment of the District Court of Guam

PETITION OF THE APPELLEE FOR REHEARING EN BANC

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Table of Authorities Cited

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R. A. Riddell, successor in office to A. G. Maddox, Commissioner of Revenue and Taxation of Guam, the appellee herein, respectfully petitions this Court pursuant to Rule 23(5) for a rehearing en banc. The Court's opinion was filed on May 5, 1967. The time within which to file a petition has been extended by the Court to July 5, 1967.

The question is whether taxpayer, a Hawaiian corporation, is a "foreign corporation" subject to the 30 percent Guam Territorial income tax on amounts received from sources within Guam by foreign corporations.[1]

The Court held that taxpayer was not required to pay tax to Guam on amounts received as interest and compensation (commissions), reversing the District Court in a *per curiam* opinion "on the authority of *Atkins-Kroll (Guam) Ltd. v. Government of Guam,* 367 F.2d 127 (9th Cir. 1966), certiorari denied, [386] U.S. [993] (1967)." This conclusion, we submit, is erroneous because:

(1) Assuming the correctness of the decision in *Atkins-Kroll* as to dividend income, that case is no authority for holding that the present taxpayer is not subject to Section 881 tax on its interest and commission income; there is here no instance of double taxation by Guam, the prevention of which was the stated basis of that decision, and the effect of the Court's decision herein is to exempt taxpayer from any Guam tax.

(2)(a) *Atkins-Kroll* incorrectly held that a California corporation was a "domestic" corpora-

[1]Section 881, Internal Revenue Code of 1954 (26 U.S.C. 1964 ed., Sec. 881), as made applicable to Guam by Section 31 of the Organic Act of Guam (48 U.S.C. 1964 ed., Sec. 1421i).

tion and thus not subject to Guam's 30 percent income tax on amounts received as dividends from sources in Guam by "foreign" corporations; and

(b) it failed to consider that the logical consequence of its holding would be to subject the California parent corporation to the corporate income tax under Section 11—not to exempt the parent corporation from all Guam income taxes.

1. Even if *Atkins-Kroll* was correctly decided as to dividend income, its rationale does not support the action taken by the Court in this case. In *Atkins-Kroll,* the Court first decided that, for Guam tax purposes, the definition of "domestic" corporation should be one "created or organized in GUAM or under the law of GUAM *or of any State or Territory.*"[2] It then moved to the crux of the problem, i.e., whether the italicized phrase should be omitted as "inapplicable language" (Section 31(e), Organic Act of Guam). Concluding that the phrase must be retained, the Court held that Atkins-Kroll's parent corporation was a "domestic" corporation of Guam and thus not subject to the Section 881 tax on the dividend. The Court reasoned that (367 F.2d, p. 129)—

> with respect to [Section 881], unless the words "or of any State or Territory" are given full application, a manifest and substantial inequity results, for otherwise the combined Guam and Federal tax burden on the income which a California corporation ultimately receives from the business of its Guam subsidiary substantially exceeds the applicable corporate income tax rate under either the laws of Guam or the United States. We find nothing to indicate that Congress

[2]The word "GUAM" indicates a substitution in Section 7701(a)(4), 1954 Code, for the words "United States."

> intended the Guam tax laws to be interpreted so as to reach such a result.[3]

Thus the basis for the decision was the Court's judgment that Congress could not have intended that Guam tax corporate earnings twice—once when earned by the corporation and once when paid to its shareholders as a dividend.

However, in the instant case, we are concerned with interest and compensation, not dividends. Such items were not subject to Guam taxes in the hands of Kirby and Company; they were deductions from gross income. 1954 Code, Sections 162, 163. Thus, the Section 881 tax is the first—and only—Guam tax to which they can be subject. Consequently, taxpayer should be taxed by Guam at least on these items even under the rationale of *Atkins-Kroll,* for there is here no double taxation.

Under the Court's opinion (disregarding for the moment Section 11), taxpayer would pay no tax to Guam notwithstanding the fact that these items were derived from activities in Guam. This result is plainly inconsistent with the Congressional motive for creating a separate Guam income tax, i.e., the independence which follows from its being able to raise revenue from its own sources for its domestic purposes and to eliminate the need for direct appropriations from the federal treasury. *Laguana v. Ansell,* 102 F.Supp.

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[3]The Court's reference to "Federal" taxes here is unclear. Atkins-Kroll paid no tax on its earnings to the United States since it was a foreign corporation neither doing business in the United States nor earning income from sources in the United States. 1954 Code, Sections 881, 882. Its California parent owed no federal tax on the dividends; it was required to include the dividends derived from Guam in its gross income for federal income tax purposes, but would have been entitled to a foreign tax credit (Sections 901-904, 1954 Code) equal to the federal tax liability incurred with respect to such dividends. See Brief for Appellant, pp. 9-11, *Atkins-Kroll (Guam), Ltd. v. Government of Guam,* 367 F.2d 127 (C.A. 9th, 1966).

919, 920-921 (Guam, 1952), affirmed *per curiam,* 212 F.2d 207 (C.A. 9th, 1954), certiorari denied, 348 U.S. 830 (1954).

Thus, further review of this case is required.

2a. As the Court noted in its *per curiam* opinion, the Government of Guam sought review by the Supreme Court of the *Atkins-Kroll* decision; we sincerely believed the decision to be erroneous and of sufficient importance to merit review.[4] Since we continue to hold that belief and since the Court's decision in this case rests entirely on the authority of *Atkins-Kroll,* we here urge its reexamination and reversal.

The decision contains two fundamental defects: (1) it violates the basic premise on which Guam's corporate tax law is based, i.e., that Guam and the United States are separate and distinct taxing jurisdictions,[5] so that Guam corporations are "foreign" for purposes of the United States income tax and United States corporations are "foreign" for purposes of the Guam tax.[6] (2) The Court's reasoning ignores the equally fundamental concept that a corporation and its shareholders are separate taxable entities, so that income may be taxed once when earned by the corporation and again when received by the shareholders as dividends.

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[4]For the information of the Court, three copies of the petition for certiorari, brief in opposition, and reply memorandum are being lodged with the Clerk.

[5]Organic Act of Guam, Sec. 31(b); *Laguana v. Ansell,* 102 F. Supp. 919 (Guam 1952), affirmed *per curiam,* 212 F.2d 207 (C.A. 9th, 1954), certiorari denied, 348 U.S. 830 (1954); *Jennings v. United States,* 168 F.Supp. 781 (Ct. Cl., 1958), vacating opinion, 155 F.Supp. 571 (1957); I.T. 4046, 1951-1 Cum. Bull. 57.

[6]Rev. Rul. 56-616, 1956-2 Cum. Bull. 589. Presumably a United States citizen resident in the United States would be a nonresident alien so far as Guam is concerned. A citizen of Guam resident in Guam is considered a nonresident alien so far as the United States is concerned. 1954 Code, Section 932; Rev. Rul. 56, 1953-1 Cum. Bull. 303.

b. The stated basis for the Court's holding in *Atkins-Kroll* was the elimination of double taxation and apparently the Court considered that its conclusion regarding Section 881 would free the corporate earnings from a second tax. The statute plainly denies this. The tax imposed by Section 881 is, by its terms "in lieu of the taxes imposed by section 11." Thus, under the scheme of the Code, the fact that shareholders are *foreign* corporations or citizens affects only the rate of the tax imposed at the shareholder level and the method of collection, but not whether they are taxed.

The logical consequence of the decision in *Atkins-Kroll* would appear to exempt from the Section 881 tax, and its implementing administrative measures, those United States corporations receiving income from Guam, but at the same time subject them to the Section 11 tax as domestic corporations of Guam. Guam taxes domestic corporations on income derived from all sources. See *Government of Guam v. Koster,* 362 F.2d 248, 249 (C.A. 9th, 1966). Thus, if a United States corporation receives *any* dividend, interest or other "fixed or determinable annual or periodical income" (Section 881) from Guam, it becomes a domestic corporation of Guam subject to Guam corporate tax on its *world-wide income.*

There are grave defects in the Court's reversal of the judgment of the District Court in this case. For the reasons stated, this petition for a rehearing en banc should be granted.

Dated: June 30, 1967.

Respectfully submitted,

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Certificate of Counsel

The undersigned counsel for the appellee hereby certifies that the foregoing petition for rehearing en banc is presented in good faith and not for the purpose of delay.

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